Fiscal Note 2017 Biennium

Governor's Office of Budget and Program Planning

Bill #	SB0171	**Title:**	Generally revise taxation of income, including the corporate income tax
Primary Sponsor:	Tutvedt, Bruce	**Status:**	As Amended in House Committee

☐Significant Local Gov Impact ✓Needs to be included in HB 2 ☐Technical Concerns

☐Included in the Executive Budget ☐Significant Long-Term Impacts ☐Dedicated Revenue Form Attached

FISCAL SUMMARY

	FY 2016 Difference	FY 2017 Difference	FY 2018 Difference	FY 2019 Difference
Expenditures:				
General Fund	$94,500	($486,696)	($740,820)	($753,129)
Revenue:				
General Fund	($13,908,000)	($20,759,000)	($20,370,000)	($21,586,000)
Net Impact-General Fund Balance:	($14,002,500)	($20,272,304)	($19,629,180)	($20,832,871)

Description of fiscal impact: SB 171, as amended, would restructure the individual income tax, reduce rates for the corporate income tax, eliminate several credits, and expand two credits. Revenue reductions would begin in FY 2016, while revenue increases from eliminating credits and cost savings would not begin until FY 2017.

FISCAL ANALYSIS

Assumptions:

Department of Revenue

1. This bill would revise the structure of the individual income tax, reduce rates for the corporate income tax, and eliminate several credits and deductions for individuals and corporations. These changes would be effective beginning with tax year 2016.
2. This bill would make federal taxable income, with a short list of adjustments, the base for the individual income tax. It would make taxable income subject to two rates, 4.7% and 6.1%, with separate rate tables for taxpayers who file a joint return, who file as head of household, and who file as single or married separate. It would require taxpayers to use the same filing status as on their federal returns. This bill also would replace the 2% capital gains credit with a 1.5% rate reduction for net capital gains.
3. The income tax forecasting model was modified to reflect these provisions of the bill. The following table shows the difference between calendar year tax liability from the modified model and the model output under current law.

Tax Year	Difference in Tax Liability (million)
2016	($21.330)
2017	($21.192)
2018	($22.665)
2019	($24.903)

4. Changes to the definition of taxable income and income tax rates would take effect at the beginning of tax year 2016, which is the middle of FY 2016. Thus tax liability would be reduced for half of FY 2016. The department would issue new withholding schedules in the fall of 2015, but both employers and taxpayers would probably take some time to adjust withholding and estimated payments. Some taxpayers would end up with unplanned over-payments in the second half of FY 2016, but others would end up with unplanned under-payments. Since the net change in tax liability is about 1%, the net of unplanned over- and under-payments also is likely to be small. Thus, the change in revenue in the second half of FY 2016 is expected to be half the change in tax liability for tax year 2016.
5. For later fiscal years, the change in revenue will equal half the change in tax liability for the tax year that overlaps the first half of the fiscal year plus half the change in tax liability for the tax year that overlaps the second half of the fiscal year. For example, the revenue change for FY 2017 will be half the change for tax year 2016 plus half the change for tax year 2017. The following table shows the revenue differences by fiscal year.

Fiscal Year	Revenue Change (million)
FY 2016	($10.665)
FY 2017	($21.261)
FY 2018	($21.929)
FY 2019	($23.784)

6. This bill would eliminate several credits and deductions that taxpayers are allowed against individual and corporate income tax. The following table shows provisions that are eliminated and the amount that each reduced revenue in the latest year for which all returns have been filed. The bill also eliminates several corporate deductions that are not reported on separate lines on the return. The impact of these deductions is unknown but is expected to be small.

Credits and Deductions Eliminated	Individual	Corporate
Empowerment Zone Credit	$0.000	$0.000
Energy Conservation Credit	$4.536	n/a
Alternative Fuel Conversion Credit	$0.008	$0.000
New and Expanded Industry Credit	n/a	$0.000
Geothermal Heating System Credit	$0.314	$0.000
Alternative Energy Production Credit	$0.000	$0.000
Mineral Exploration Credit	$0.000	$0.000
Biodiesel Production Facility Credit	$0.000	$0.000
Biodiesel Blending and Storage Credit	$0.002	$0.000
Alternative Energy System Credit	$0.633	n/a
Total	**$5.493**	**$0.000**

7. As amended in the House Taxation committee, this makes the film credits permanent and expands eligibility for the elderly homeowner/renter credit to residents of tax-exempt housing for 2015 and 2016. The following table shows the annual amount of these additional credits.

Costs of Credits Added to SB 171 as Ameded in the House ($ million)

Film Credits	$0.154
Expanded Homeowner/Renter Credit Eligibility	$0.360
Total	**$0.514**

8. Some taxpayers who claim a credit do not have enough tax liability to use the whole credit. With some credits, taxpayers are allowed to carry unused credits forward to offset tax liability in later years. For the last year of returns, credits carried forward were approximately 4.3% of individual income tax credit claims. This fiscal note assumes that the same percentage of 2015 credits will be carried forward and that two-thirds of those carry-forwards will be used to offset 2016 taxes and one-third will be used to offset 2017 taxes.
9. The revenue impact of extending the film credits and expanding eligibility for the homeowner/renter credit would first show up when taxpayers file their 2015 returns in FY 2016. The revenue impact of eliminating credits and deductions would first show up when taxpayers file their 2016 returns in FY 2017. In HJ 2, income tax credits are forecast as a group and corporate license tax credits are not explicitly forecast. The following table shows the revenue impacts of changes to credits and deductions assuming that the eliminated income tax credits would grow at the rates forecast in HJ 2 and that corporate credits and deductions would be constant.

Revenue Impacts of Changes to Credits and Deductions
($ million)

	FY 2016	FY 2017	FY 2018	FY 2019
Individual Income Tax				
Growth From 2013	$0.212	$0.277	$0.335	$0.392
Changed Credits	($0.514)	$6.500	$7.180	$7.490
Pre 2016 Carry-Over		($0.201)	($0.101)	
Corporate Income Tax		$0.000	$0.000	$0.000
Total	**($0.514)**	**$6.300**	**$7.077**	**$7.493**

10. Under current law, individual taxpayers are required to make a number of adjustments to federal adjusted gross income. Some of these require taxpayers to carry adjustments made in one year forward to a future year. This bill would allow taxpayers who have adjustments carried forward from previous years to use them in 2016, but not in later years. Taxpayers with net adjustments that would decrease taxable income are assumed to take advantage of this option. If this option had applied to 2013 returns, total taxable income would have been reduced by $2.906 million. HJ 2 assumes that these adjustments will increase by 12.7% from 2013 returns to 2016 returns. Assuming that taxpayers who use this option will be in the new top rate bracket, this transition provision will reduce tax liability on 2016 returns by $0.196 million. This effect will occur in FY 2017 when taxpayers file their returns for tax year 2016.
11. This bill would reduce the corporate income tax rate to 6.5% for most corporations and to 6.75% for corporations that make the water's-edge election. Tax liability was recalculated for the latest available year of returns using the rates in this bill. Tax liability with this bill was approximately 3.67% lower. Corporations would immediately reduce their estimated payments due to the lower rates. Revenue in FY 2016 would be reduced for the second half of the year, so the reduction would be 1.835%. In later fiscal years, revenue would be reduced by 3.67%. The following table shows the revenue impacts of reduced corporate income tax rates.

Revenue Impacts of Lower Corporate Income Tax Rates
($ million)

FY 2016	FY 2017	FY 2018	FY 2019
($2.729)	($5.602)	($5.518)	($5.295)

12. The following table shows the revenue impact of each component of this bill and the total.

Net Change in General Fund Revenue ($ million)

	FY 2016	FY 2017	FY 2018	FY 2019
Individual Income Tax Restructuring	($10.665)	($21.261)	($21.929)	($23.784)
Eliminating Credits and Deductions	($0.514)	$6.300	$7.077	$7.493
Individual Income Tax Transition		($0.196)		
Corporate Income Tax Rate Change	($2.729)	($5.602)	($5.518)	($5.295)
Net Change	**($13.908)**	**($20.759)**	**($20.370)**	**($21.586)**

13. Changes to tax forms and instructions would be made as part of the annual update process with no additional costs. One-time costs to have the vendor make changes to the department's data processing systems would be $94,500 in FY 2016.
14. With a shorter, simpler form and instruction booklet, the department would be able to reduce costs in several areas. Ongoing costs for annual form updates would be lower, with one-fourth an employee's time being saved. There would be fewer taxpayer calls with questions, and the department would be able to reduce call center staffing by 1.00 FTE. The costs of processing returns will be reduced, and processing staff would be reduced by 3.00 FTE. With a much smaller number of lines on the return, less work would be required to maintain and update the department's data processing system. The department would eliminate 1.00 FTE in information technology in FY 2017. Taxpayers would make fewer mistakes on returns, and with fewer credits and adjustments to income and no itemized deductions, there would be fewer items to verify and audit. The department would be able to reduce auditing staff by 3.00 FTE in FY 2017 and by an additional 2.00 FTE in 2018. With fewer potential areas for disputes between the department and taxpayer, the department would be able to eliminate 1.00 FTE lawyer beginning in FY 2018. The following table shows costs and cost savings by function.

	FY 2016	FY 2017	FY 2018	FY 2019
Information Technology				
personal services		($74,830)	($76,114)	($77,423)
operating costs		($6,704)	($6,805)	($6,907)
contracted services	$94,500			
Forms Design and Call Center				
personal services		($56,866)	($57,791)	($58,733)
operating costs		($6,704)	($6,805)	($6,907)
Return Processing				
personal services		($111,054)	($112,637)	($114,252)
operating costs		($20,112)	($20,415)	($20,721)
Legal				
personal services			($96,951)	($98,890)
operating costs			($6,805)	($6,907)
Return Auditing				
personal services		($190,314)	($322,472)	($327,854)
operating costs		($20,112)	($34,025)	($34,535)
Total	**$94,500**	**($486,696)**	**($740,820)**	**($753,129)**

Fiscal Impact:	FY 2016 Difference	FY 2017 Difference	FY 2018 Difference	FY 2019 Difference
FTE	0.00	8.00	11.00	11.00
Expenditures:				
Personal Services	$0	($433,064)	($665,965)	($667,152)
Operating Expenses	$94,500	($53,632)	($74,855)	($75,977)
TOTAL Expenditures	$94,500	($486,696)	($740,820)	($743,129)
Funding of Expenditures:				
General Fund (01)	$94,500	($486,696)	($740,820)	($743,129)
TOTAL Funding of Exp.	$94,500	($486,696)	($740,820)	($743,129)
Revenues:				
General Fund (01)	($13,908,000)	($20,759,000)	($20,370,000)	($21,586,000)
TOTAL Revenues	($13,908,000)	($20,759,000)	($20,370,000)	($21,586,000)
Net Impact to Fund Balance (Revenue minus Funding of Expenditures):				
General Fund (01)	($14,002,500)	($20,272,304)	($19,629,180)	($20,842,871)

Sponsor's Initials *Date* *Budget Director's Initials* *Date*